

A Message from the Governor

I am pleased to present the ninth annual edition of the Michigan Financial Focus. This 2005 edition provides citizens with an overview of the financial condition of the State of Michigan as of September 30, 2004. Selected financial, economic, and demographic information is provided to help you learn more about Michigan's budget and the state's finances.

In the face of declining federal assistance, increasing Medicaid caseloads and lackluster revenue growth, the budget challenges we face today remain serious. Michigan faces a \$770 million shortfall for fiscal year 2006. To address this difficult task, I have reformed the budget process to focus spending on providing services that matter most to citizens. As a result, my proposed budget for the coming fiscal year increases funding for K-12 education, protects funding for public safety and health care, provides funding for job-creation initiatives, reforms the state purchasing system and implements administrative efficiencies throughout state government. My budget prioritizes both expenditures and tax subsidies to focus spending on those activities that deliver results that matter most to the public.

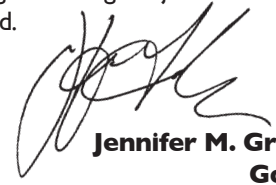
The budget focuses state spending in six priority areas – Education, the Economy, Health and Human Services, Hometown Security, the Environment and Better Government – and justifies every expenditure and every tax subsidy – to ensure we spend every penny wisely. My budget for the coming year provides the balance we need to build a better Michigan. The budget reflects many difficult choices, including \$390 million in spending reductions. Despite the significant cuts, the proposal protects those things that make Michigan a great place to live – the schools where our children learn and grow, the clinics and hospitals that provide our health care, and police officers and fire fighters who keep our communities safe. It accomplishes all of this, while at the same time creating jobs and keeping our tax structure competitive.

While the process by which the budget is constructed has changed, the priorities of the citizens and job providers have not. We seek a lean government that offers critical services for the best price available. Job providers seek a competitive tax structure and a high quality of life – from

a solid educational system to affordable health care to a wonderful place to work, play and raise a family.

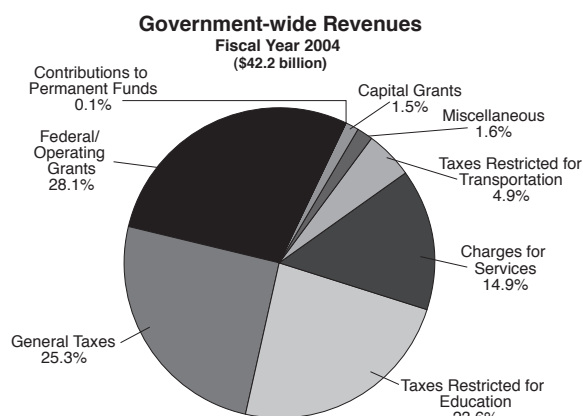
Even during the most challenging of economic times, my budget provides this, without raising general taxes. Because the budget relies on cuts instead of one-time fixes, it continues efforts to address the structural problems. Make no mistake about it; this was not an easy task. We made bold decisions to balance our budget – decisions that reduce spending for important initiatives. These decisions were made in order to promote economic growth and create a better Michigan.

I am proud of the steps we have taken thus far and I look forward to continuing to work toward the vision we seek: a strong, healthy Michigan where good jobs and a high quality of life go hand in hand.

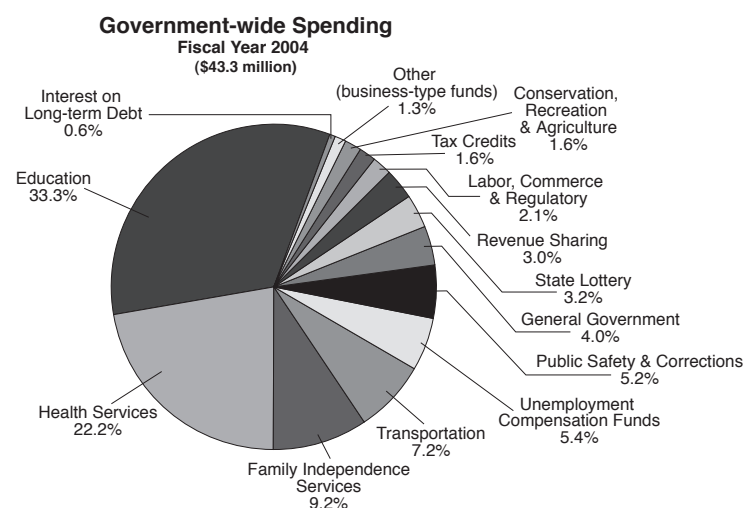

Jennifer M. Granholm
 Governor

Government-wide Activities

Government-wide activities provide a broad view of the state's operations. Government-wide activities present the combined financial position and operating results of all state funds, excluding fiduciary funds (e.g., pension funds). State revenues totaled \$42.2 billion in fiscal year 2004. Fund balances and other state assets were also used to support government programs. As shown in the accompanying chart, 28.1% of Michigan's revenue came from operating grants, primarily from the Federal Government and were earmarked for specific uses. In addition, the State Constitution and other statutory restrictions earmarked 28.5% for education and transportation purposes. Only 25.3% of the state's revenues are available for general use.



On a government-wide basis, Michigan spent \$43.3 billion during fiscal year 2004 to provide services to the citizens of Michigan. Total expenditures include spending appropriated in prior fiscal years, such as capital outlay and work project authorization. As evidenced by the accompanying chart, education and health services represent Michigan's largest spending categories, accounting for 55.5% of the state's spending.

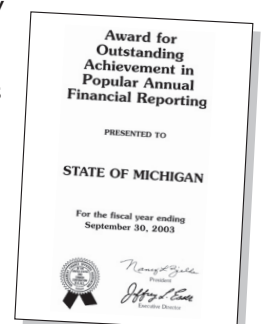


Michigan Recognized for Financial Reporting Excellence

Michigan is recognized as a national leader in state government financial reporting. In its recent report card on government performance of the states, *Governing Magazine* gave Michigan high marks for timely and accurate financial reporting – only two states scored higher than Michigan. In fact, *Governing* mentioned this report as an example of the way Michigan excels in educating the public and engaging them in budgetary deliberations. *Governing* was particularly impressed by the fact that for three consecutive years the state has issued its Comprehensive Annual Financial Report (CAFR) within 90 days of the end of the fiscal year – a feat yet to be accomplished by any other state. By issuing the financial statements in such a timely manner, the State minimizes the cost of preparing the statements. It also means that audited financial information is available earlier for use by the Governor, the Legislature, and other key decision makers.

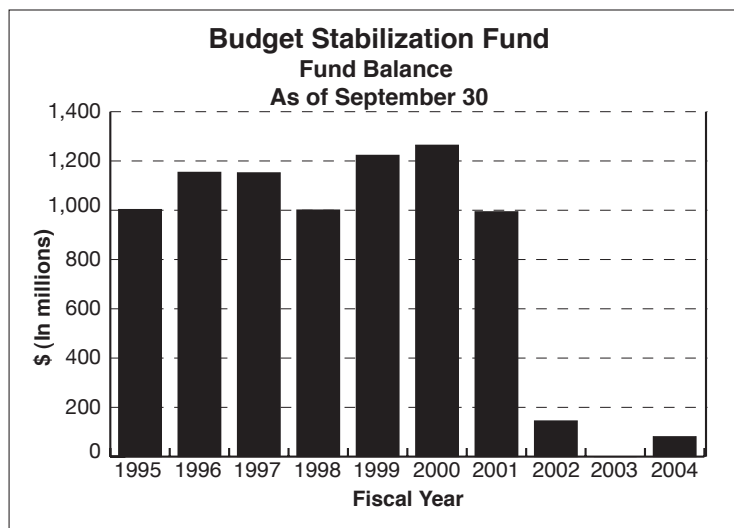
Michigan has also been recognized for excellence in financial reporting by the Government Finance Officers Association (GFOA), with its CAFR receiving the GFOA Certificate of Achievement for Excellence in Financial Reporting for seventeen consecutive years and this report being awarded the GFOA Award for Outstanding Achievement in Popular Annual Financial Reporting for eight consecutive years. These awards are prestigious national awards recognizing conformance with the highest standards for preparation of government comprehensive annual financial reports and popular reports. We believe this edition of Michigan Financial Focus continues to conform to the Popular Annual Financial Reporting requirements, and we are submitting this report to GFOA to determine its eligibility for another award.

We are proud of Michigan's reputation as a national leader in financial reporting, but we are also interested in finding new and innovative ways to continue to improve our reporting to the citizens of Michigan. If you have comments or suggestions for improving this report, please visit www.Michigan.gov/ofm to give us your input.



Budget Stabilization Fund

The Counter Cyclical Budget and Economic Stabilization Fund, commonly referred to as the Budget Stabilization Fund or the "Rainy Day Fund," was created in 1977 to serve as Michigan's "savings" account and to assist in stabilizing revenues during periods of economic recession. The fund provides a safeguard to protect critical programs for Michigan's citizens when the state experiences an economic downturn. The following chart shows the year-end fund balances for the Budget Stabilization Fund for the last ten fiscal years:



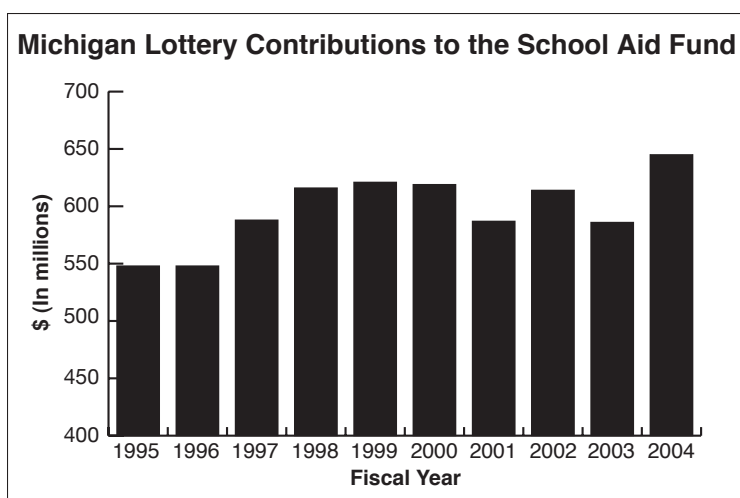
As Michigan's revenues continued the decline that started in fiscal year 2001, the Legislature authorized transfers from the fund to protect critical programs. As a result, the fund balance, which peaked at \$1.3 billion on September 30, 2000, was eliminated by September 30, 2003.

During fiscal year 2004, Michigan was able to increase the fund balance for the first time since fiscal year 2000. As of September 30, 2004, the Budget Stabilization Fund balance was \$81.3 million.

Michigan Lottery

The Michigan Lottery was created by law in 1972. The net profit from lottery operations is transferred to the School Aid Fund to help support K-12 education. Since its inception, the Michigan Lottery has achieved \$32.1 billion in ticket sales, transferred \$12.1 billion to the School Aid Fund, awarded \$16.7 billion in prizes, and paid \$2.2 billion in retailer commissions.

During fiscal year 2004, the Lottery posted its highest sales ever (\$1.97 billion), resulting in a record contribution of \$644.9 million to the School Aid Fund. In addition, Lottery players collected prizes worth \$1.1 billion and retailers received commissions of \$145.3 million. The following chart shows the Lottery's contributions to the School Aid Fund for the last ten years.



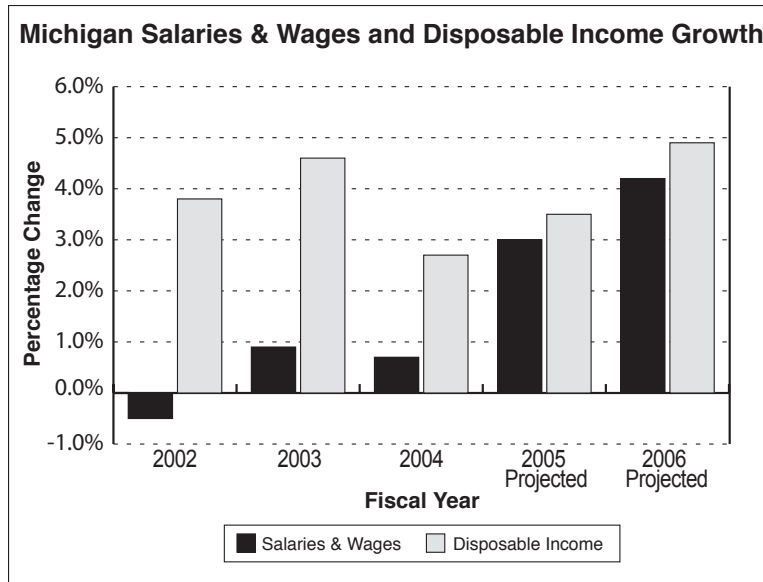
Economic Outlook

Michigan's economy continues to suffer from the effects of a prolonged national economic slowdown. While the U.S. economy shows signs of improvement, the manufacturing sector, which is a major component of Michigan's economy, has been slower to recover than the overall economy. As a result, Michigan's recovery has lagged behind the national trends.

Michigan's largest taxes are the individual income tax and sales and use taxes. There is a strong correlation between income tax collections and salaries and wages. After four years of declining or flat growth, salaries and wages are forecast to rise by 3.0 percent in fiscal year 2005 and 4.2 percent in fiscal year 2006. Sales and use taxes, on the other hand, are more directly correlated with disposable income, which is forecast to increase by 3.5 percent in fiscal year 2005 and 4.9 percent in fiscal year 2006. Disposable income is forecast to rise faster than salaries and wages because of federal tax cuts and inflation rates below the growth in salaries and wages.

The upward trend in salaries and wages and disposable income is encouraging, but it does not translate directly into increased state revenues. In fact, the state estimates that combined General Fund and School Aid Fund revenues will increase only 0.5 percent in fiscal year 2005 and 3.8 percent in fiscal year 2006. The

discrepancy between the personal income forecasts and the revenue estimates can be attributed to a number of factors, including shifts in federal policies that reduce state revenues, and the fact that consumer confidence remains low.



Source: Research Seminar in Quantitative Economics, University of Michigan, and Consensus Forecast, January 2005

School Aid Fund

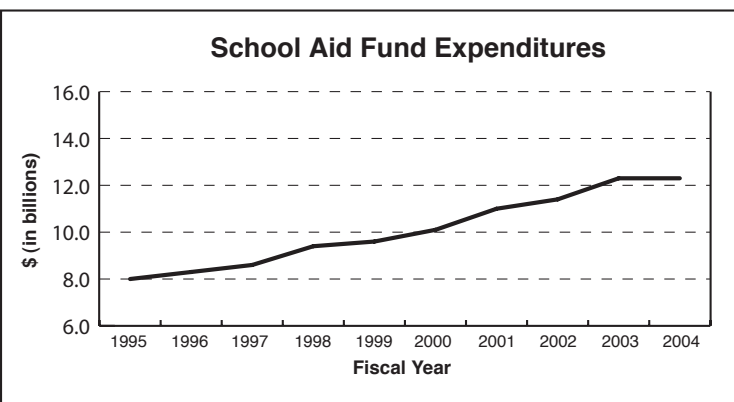
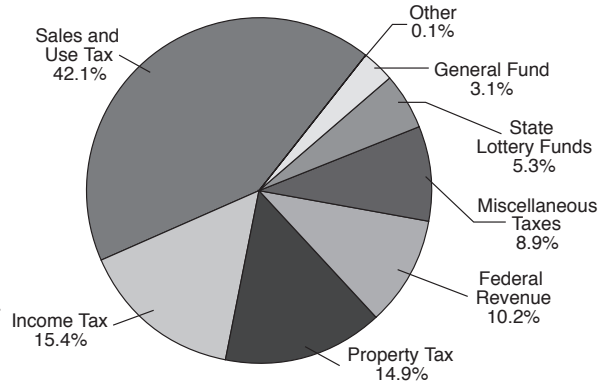
K-12 education is funded from the School Aid Fund, which was created in 1955 by an amendment to the 1908 State Constitution, and the 1963 State Constitution provided for its continued existence. Its purpose is to furnish aid to public schools, charter schools, and intermediate school districts of the state. Financial assistance is based on a statutory formula that uses, among other items, pupil membership counts and property tax data.

Michigan spent \$12.3 billion in fiscal year 2004 for its K-12 school program. This marked the seventh year in a row that education spending was the largest category in the Michigan's budget. The chart below shows the expenditures for the School Aid Fund for the last ten years.

The School Aid Fund receives its revenues from seven principle sources: (1) the constitutional dedication of 60% of the collections of sales tax imposed at a rate of 4% and all of the collections of the sales tax imposed at the additional rate of 2%; (2) a portion of the personal income tax; (3) state

education (property) tax; (4) State Lottery earnings; (5) approximately 33% of total state use tax revenue; (6) 8.1% of the gross casino gaming revenue; and (7) portions of the cigarette, liquor, industrial and commercial facilities taxes and federal funds. A summary of fiscal year 2004 funding sources is included in the pie chart above.

School Aid Fund
Fiscal Year 2004 Funding Sources
(\$12.3 billion in total)



Trends in Tax Revenue

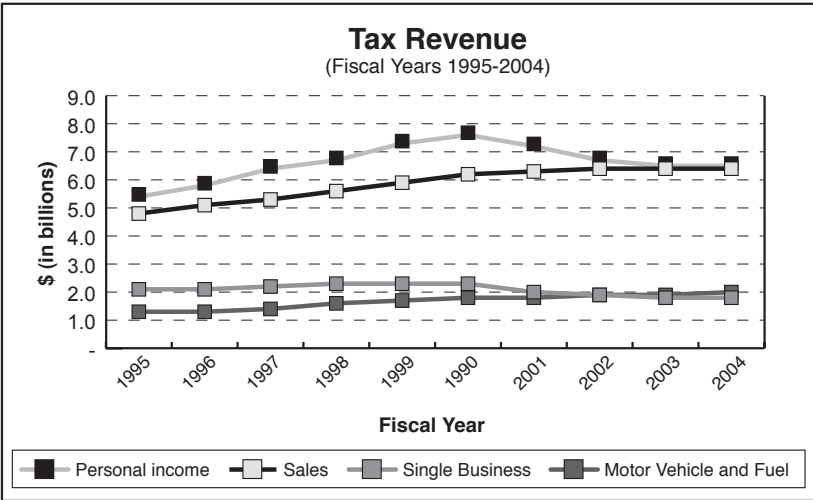
Taxes represent a significant portion of the revenues the state uses to fund programs and services to citizens, totaling 54% of government-wide revenues in fiscal year 2004. During fiscal year 2004, the state's governmental funds recorded tax revenues of \$22.8 billion. Four specific taxes comprise about 74% of the State's taxes:

- Personal income taxes represent the largest source of tax revenue, consisting of \$6.6 billion, or 28.8% of total taxes. Adopted in 1967, this is a direct tax on income. Beginning in calendar year 1999 and continuing through 2004, the tax rate was reduced 0.1% per year until the rate reached 3.9%. Nearly 29% of this tax is dedicated to the School Aid Fund, with the remainder distributed to the General Fund.
- Sales taxes are the second largest tax revenue; comprising \$6.5 billion, or 28.4% of total taxes. This tax was adopted in 1933 and is derived from the retail sale of tangible personal property for use or consumption, and from other sources. A majority (73%) of the sales tax is dedicated to the School Aid Fund, with the remainder going to local units of government, the General Fund, and transportation-related funds.
- Motor vehicle and fuel tax includes taxes on motor vehicle registrations and an assessment on the sale of automotive and aviation

fuel. The state first imposed the vehicle registration tax in 1905 and the fuel tax was originally adopted in 1925. During fiscal year 2004, the tax generated \$2.0 billion, or 8.8% of total taxes. Motor vehicle and fuel tax is used primarily to pay for roads, highways, bridges, and public transportation throughout the state.

- The single business tax, the only general business tax levied by the state, generated \$1.8 billion, or 8.1% of total taxes in fiscal year 2004. This tax is being phased out over several years. Since fiscal year 1999, the rate has been reduced from 2.3% to its current rate of 1.9%. The single business tax is distributed to the General Fund to finance various state programs.

The following graph displays the trend for these four major taxes over the past 10 years.

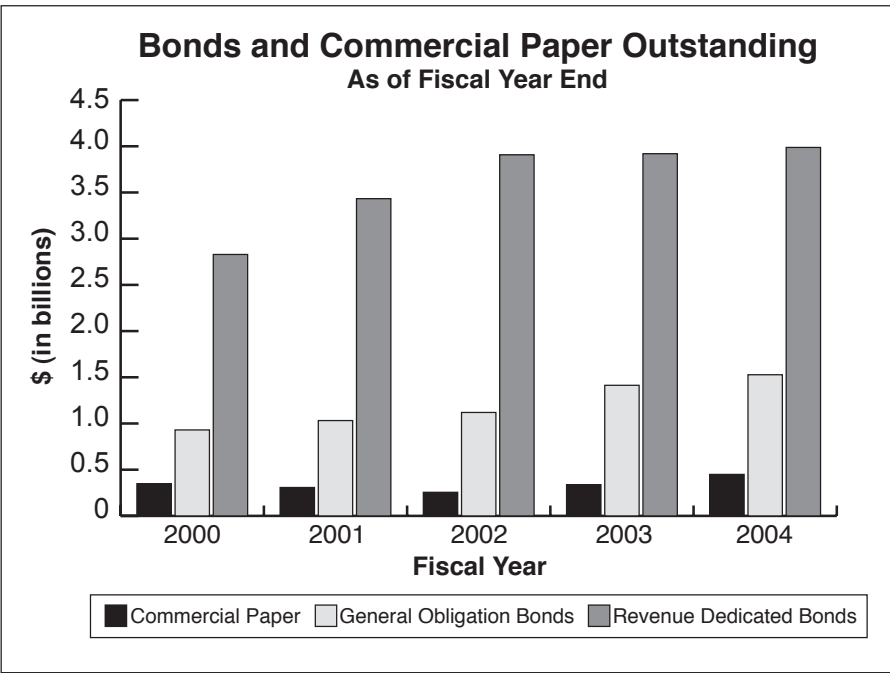


Debt Management

The State borrows money for a variety of construction, repair, and renovation projects involving state highways, higher education facilities, state park improvements and state government buildings. State borrowing also provides financing to local school districts for school buildings and renovations. In addition, the State issues Clean Michigan Initiative bonds to finance environmental cleanup, pollution prevention, and redevelopment projects.

The State's borrowing consists of general obligation bonds, revenue dedicated bonds, and short-term commercial paper. General obligation bonds, approved by the voters, are backed by the full faith and credit of the State and are generally

repaid from unrestricted revenue sources. Revenue dedicated bonds typically finance specific projects with the stipulation that financing comes strictly from designated revenue sources, such as transportation revenues that support road construction activities.



Infrastructure Assets

Infrastructure assets are long-lived capital assets that normally are stationary in nature and typically can be preserved for a significantly greater number of years than most other capital assets. Examples of infrastructure assets include roads, bridges, railroads, tunnels, drainage systems, water and sewer systems, dams, and airports. The Department of Transportation is responsible for the construction and maintenance of the majority of the state's infrastructure assets.

The state uses an asset management system that measures and assesses the condition of its roads and bridges. This system helps to identify the short and long-range spending that will be necessary to preserve the state's road system. Michigan's goal is to have 90% of its roads in good condition and 90% of its bridges in good or fair condition by 2008. Currently, 80% of roads are in good condition and 83% of bridges are in good or fair condition. During fiscal year 2004, the State spent \$857.6 million to preserve and maintain roads and bridges at the condition levels cited above.

Michigan's roads, bridges, and other infrastructure assets are valued at over \$12.3 billion. Following are the historical costs of these assets:

Infrastructure Assets
As of September 30, 2004
(in millions)

Asset Types	Amount
Roads	\$10,416.6
Bridges	1,282.7
Ramps	512.7
Rest Areas	60.2
Railroads	35.0
Miscellaneous	16.6
TOTAL	\$12,323.8

Commercial paper is generally short-term in nature and repaid from the proceeds of bond issuances.

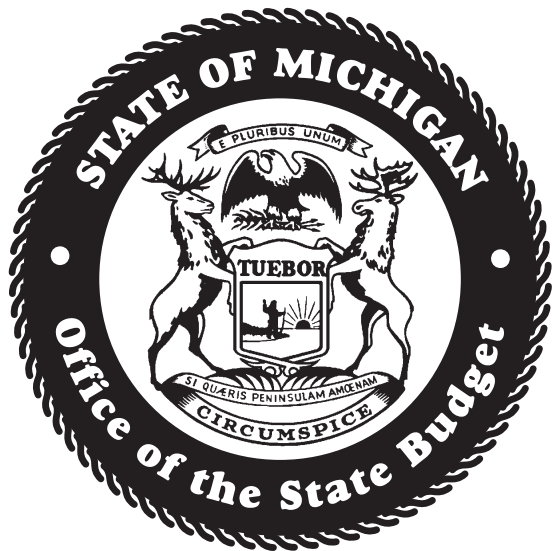
The State's outstanding debt totaled \$6.0 billion as of September 30, 2004. This represents an increase of \$292.8 million (4.9%) over September 30, 2003. The bar chart depicts the State's outstanding general obligation bonds, revenue bonds, and commercial paper over the past five years.

Similar to re-financing a home, Michigan frequently "refunds" outstanding debt. This allows the state to borrow money at a lower interest rate than the original bonds and pay off the original amount outstanding with proceeds from the new bonds. This process results in reduced borrowing costs for Michigan. Starting in fiscal year 2002, Michigan began an aggressive restructuring of its long-term debt to take advantage of favorable market conditions.

Michigan's current bond rating is Aa2 from Moody's Investor Services and AA+ from Standard & Poor's. Overall, Michigan's bond rating is exceeded by only nine states in Standard & Poor's ratings and eighteen states in Moody's ratings. Only three states with a larger population than Michigan hold a higher rating from Moody's. Michigan remains better than the national average in debt per capita and as a percentage of personal income as shown in the table to the left.

Net Tax Supported Debt as a Percentage of Personal Income		Net Tax Supported Debt Per Capita	
Lowest rate (Nebraska):	.1%	Lowest debt (Nebraska):	\$43
Highest rate (Hawaii):	10.4%	Highest debt (Connecticut):	\$3,558
Average:	3.1%	Average:	\$944
Michigan:	2.2%	Michigan:	\$670
Rank:	22nd best	Rank:	24th best

Source: Moody's Investors Service, April 2004



How to Contact Us

You can obtain additional copies of this report and other more detailed information, such as the State of Michigan Comprehensive Annual Financial Report and Executive Budget, by visiting the Office of the State Budget Internet homepage: www.michigan.gov/budget. We can also answer your questions about government financial issues at 517-373-1010.

We Value Your Feedback

Did you find this report useful? What would you do to improve the report? Please take a quick survey regarding this report on our web page at www.michigan.gov/ofm. Select the link for Popular Report to Citizens to find the survey. Thank you!

State of Michigan Directory

Point of Interest	Website Address	Director/Executive Officer	Phone Number (517)
State of Michigan Homepage	michigan.gov		
Executive Branch			
Governor's Office	michigan.gov/gov	Jennifer M. Granholm, Governor John D. Cherry, Jr., Lieutenant Governor	373-3400 373-6800
Departments & Agencies			
Agriculture	michigan.gov/mda	Dan Wyant, Director	373-1052
Attorney General	michigan.gov/ag	Mike Cox, Attorney General	373-1110
Civil Rights	michigan.gov/mdcr	Linda V. Parker, Director	335-3164
Civil Service	michigan.gov/mdcs	James D. Farrell, Director	373-3020
Community Health	michigan.gov/mdch	Janet Olszewski, Director	373-3500
Corrections	michigan.gov/corrections	Patricia L. Caruso, Director	373-0720
Education	michigan.gov/mde	Jeremy Hughes, Acting Superintendent of Public Instruction	373-3354
Environmental Quality	michigan.gov/deq	Steven E. Chester, Director	373-7917
Human Services	michigan.gov/dhs	Marianne Udow, Director	373-2000
History, Arts and Libraries	michigan.gov/hal	William Anderson, Director	373-2486
Information Technology	michigan.gov/dit	Teresa M. Takai, Director	373-1006
Labor and Economic Growth	michigan.gov/cis	David C. Hollister, Director	335-5883
Lottery	michigan.gov/lottery	Gary C. Peters, Commissioner	335-5608
Management and Budget - Administration	michigan.gov/dmb	Mitch Irwin, Director	373-1004
Management and Budget - Budget	michigan.gov/budget	Mary Lannoye, State Budget Director	373-4978
Military and Veterans Affairs	michigan.gov/dmva	Major General Thomas G. Cutler, Director	483-5507
Natural Resources	michigan.gov/dnr	Rebecca A. Humphries, Director	373-2329
State	michigan.gov/sos	Terri Lynn Land, Secretary of State	373-2510
State Police	michigan.gov/msp	Colonel Tadarial J. Sturdivant, Director	336-6157
Transportation	michigan.gov/mdot	Gloria J. Jeff, Director	373-2114
Treasury	michigan.gov/treasury	Jay B. Rising, State Treasurer	373-3223
Judicial Branch			
Supreme Court	courts.michigan.gov	Carl L. Gromek, State Court Administrator	373-0128
Court of Appeals	courts.michigan.gov/supremecourt courtofappeals.mijud.net	Clifford W. Taylor, Chief Justice William C. Whitbeck, Chief Judge	373-0126 373-3834
Legislative Branch			
Auditor General	audgen.michigan.gov	Thomas H. McTavish, Auditor General	334-8050
House of Representatives	house.mi.gov		
* Republican Homepage	gophouse.com	Craig DeRoche, Speaker	373-0827
* Democratic Homepage	housedems.com	Dianne Byrum, Minority Leader	373-0587
Senate	senate.michigan.gov		
* Republican Homepage	senate.michigan.gov/gop	Kenneth R. Sikkema, Majority Leader	373-0797
* Democratic Homepage	senate.michigan.gov/demcaucus	Robert L. Emerson, Minority Leader	373-0142
Michigan Compiled Laws	michiganlegislature.org		
Miscellaneous			
Michigan Economic Development Corporation	medc.michigan.org	Donald E. Jackway, President and CEO	373-9808
Travel Michigan	michigan.org		

Facts About Michigan

History: First permanent French settlement by Father Jacques Marquette at Sault Ste. Marie, 1668; French forces surrendered Detroit to British at close of French and Indian War, 1760; became part of the Northwest Territory, 1787; became Michigan Territory, 1805; admitted to the Union as the twenty-sixth state on January 26, 1837.

Location: It is located in the East North Central Census Region and is bordered by Canada and the states of Ohio, Indiana, and Wisconsin.

Area: 58,110 square miles of land mass (exclusive of 1,305 square miles of inland water and 38,575 square miles of Great Lakes water area) with 3,288 miles of shoreline on four of the five Great Lakes. A combined water and land area of 97,990 square miles makes it the tenth largest state.

Elevation: The highest point in the state is Mt. Arvon in Baraga County, 1,981 feet above sea level; the lowest point is along the Lake Erie shoreline, 572 feet above sea level.

Name: The name "Michigan" is derived from the Indian word Michigama, meaning great or large lake.

Nickname: The Wolverine State.

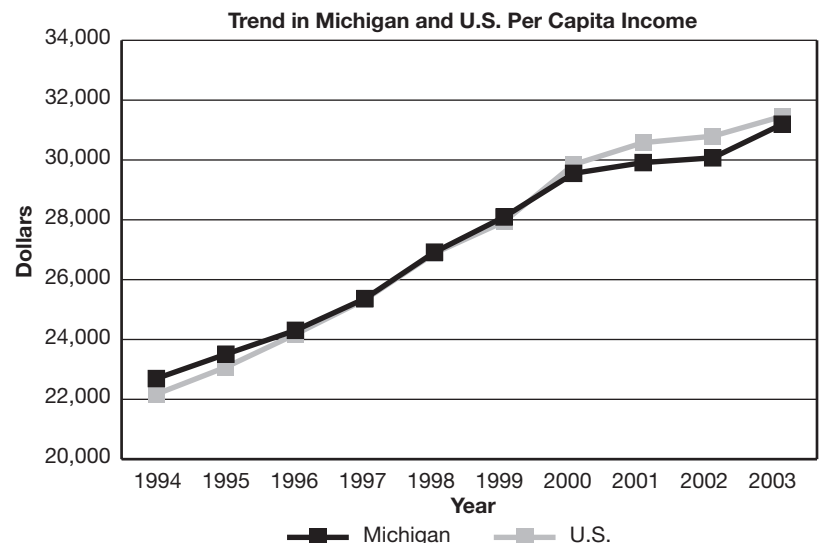
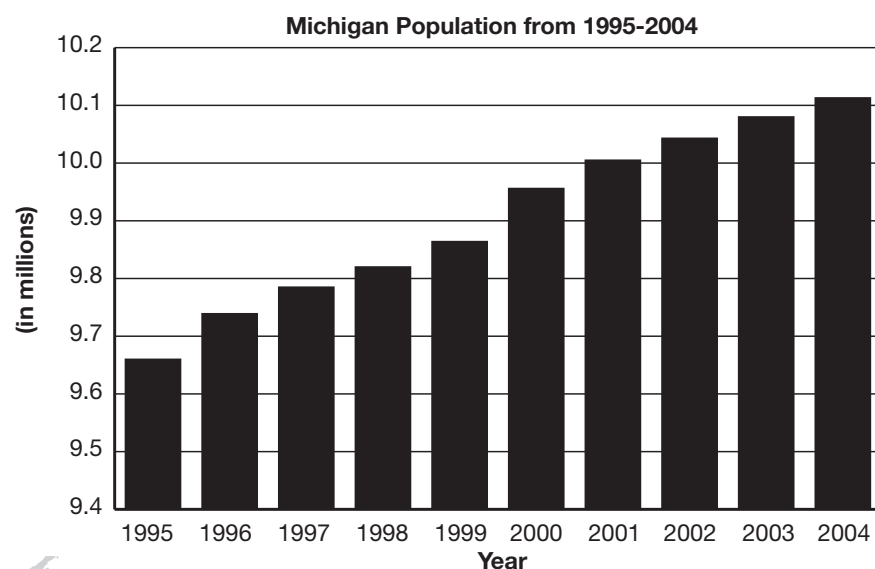
Motto: Si quaeris peninsulam amoenam circumspice (If you seek a pleasant peninsula, look about you.)

Capital: Detroit served as the state capital until 1847, when it was permanently moved by the Legislature to Lansing.

Population: The U.S. Census Bureau estimated Michigan's population to be 10,112,620 in 2004. Michigan's population ranks eighth among the 50 states. The bar chart (below left) presents estimated population trends for Michigan for the last ten years.

Per Capita Income: Michigan's estimated per capita income for 2003, the most recent year for which census income data was available, was \$31,196. The following chart (below right) compares Michigan and U.S. per capita income for the last ten years.

Sources: 2003-2004 Michigan Manual, U.S. Census Bureau, Population Division, U.S. Department of Commerce, Bureau of Economic Analysis, September 2004 release.



This publication was produced by the Department of Management and Budget at a cost of \$4,496.5 or \$.115 per copy. 39,100 copies were printed. Its purpose is to provide useful financial information concerning the State of Michigan to the citizens of Michigan.

